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SUBJECT: Shenzhen Development Bank Forging New Territory with  
Chinese Regulators

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11. (SBU) Summary: Shenzhen Development Bank (SDB), the first company  
to list publicly in China, is working closely with Chinese  
regulators to clarify untested regulations governing China's  
financial system especially as they relate to proprietary  
information, according to the bank's American chairman. He  
described a positive relationship with regulators and expressed  
satisfaction in helping raise professional standards of bank staff,  
but expects tight controls on lending to continue next year. End  
summary.

Breaking New Ground in Regulatory System  
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12. (SBU) SDB has had to work closely with Chinese securities and  
banking regulators to clarify untested regulations in China's  
financial system, according to SDB Chairman and CEO Frank Newman.  
Newman told us December 18 that on several occasions bank executives  
have had to repeatedly question instructions from regulators to  
determine exactly what was required under Chinese regulations. For  
example, Chinese Securities Regulatory Commission (CSRC) officials  
notified the bank that, according to Chinese regulations, it would  
have to publicize all resolutions reached at board meetings  
immediately after the decisions were made. SDB executives raised  
concerns about releasing proprietary information that could give  
competitors an advantage. After several discussions with  
regulators, the two sides agreed that SDB could fulfill its  
obligations by publishing a summary of board resolutions. Newman  
said that SDB was currently engaged in a similar process with CSRC  
over the legality of board director elections after one of the  
board's independent supervisors had been disqualified by CSRC.  
Christina Bao, Newman's special assistant, noted that because SDB  
was the first company in China to list publicly (its ticker code is  
000001), it had often been the first to test securities regulations.

13. (SBU) Newman explained that several discussions on the limits of  
Chinese regulations had revolved around the meaning of the word  
"advice." On more than one occasion, regulators offered SDB  
"advice" on its operations when the "advice" was really intended as  
a requirement. Newman first had to clarify the regulators' intent  
and then sometimes questioned the regulatory basis for the  
requirement.

Shared Goal of Success  
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13. (SBU) Despite this series of discussions with regulators, Newman described SDB's relationship with them as positive overall. Newman said that CSRC and the Chinese Banking Regulatory Commission (CBRC) were both supportive of Newbridge Capital's equity stake in SDB and wanted the foreign investment venture to succeed. He acknowledged that Newbridge is not in the banking business for the long haul. It will sell its stake in SDB once the value of its investment has risen enough. However, he emphasized that Newbridge's strategy was not to buy companies and flip them for a quick profit and the firm wanted to avoid that kind of reputation. Instead, Newbridge plans to add substantial value to SDB before divesting its stake.

#### Anticipating Tighter Controls

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14. (SBU) When asked about recent controls on bank lending, He Zhijiang, SDB's Treasurer, affirmed that they were currently very tight. He complained of the difficulty banks face in turning a profit with such limited ability to issue loans. Newman commented that he expected CBRC to give SDB a specific lending cap for 2008. He noted that in a conversation in Beijing, senior banking officials had expressed frustration with the limited range of tools at their disposal for controlling monetary expansion. They told him they would prefer to use open market operations or other more sophisticated tools but lacked such options for now.

#### IPO Problems

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15. (SBU) Newman also complained about the effect of initial public offerings (IPOs) on China's financial sector. He explained that every time there's a major IPO, SDB depositors withdraw large amounts of funds and transfer them to the four major banks that

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handle IPOs in hopes of being able to purchase the undervalued shares. He said the total value of the withdrawals from SDB can reach RMB 15 billion (US\$2 billion) for high-profile IPOs -- much of which returns back to SDB after the IPO. He also criticized the lottery-like impact of IPOs on income distribution in China, noting that they reward the well connected and the lucky. He also pointed out the much of the same criticism could be made of IPOs in the United States.

#### Lessons Learned After 2 1/2 Years

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16. (SBU) Looking back on the accomplishments of his first two and a half years as Chairman of SDB, Newman underscored raising the professional standards of the bank's staff. In particular, he noted a standardized code of conduct that was issued to all bank employees on his instructions. Senior banking regulators have held it up as an example for banks all over China, according to Newman. He also pointed to successful efforts to establish central financial control over bank branches, explaining that without such controls a single bad branch manager can bring down the whole bank.

#### Newbridge and Newman - Background and Bio

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17. (U) Newbridge purchased an 18-percent stake in SDB in 2004 for approximately US\$150 million. It controls four seats on the 17-member board. Bao Steel bought a 5.4 percent stake in SDB for US\$571 million in December 2007 to become the second largest shareholder, controlling one board seat. As of September 30, 2007, SDB held deposits totaling RMB 288 billion (about US\$3.8 billion) and had a non-performing loan ratio of 6.41 percent, down from 7.98 percent at the start of 2007. The bank earned a net profit of RMB 1.87 billion (US\$250 million) during the first nine months of the year, up 110 percent from the same period a year earlier.

18. (U) Frank Newman joined Shenzhen Development Bank as chairman and CEO in June 2005. His banking career began at Citigroup in 1969 and included positions at Wells Fargo and Bank of America before Newman joined the U.S. Department of the Treasury in 1993. He served first

as Under Secretary for Domestic Finance and then as Deputy Secretary from 1994 to 1995. Subsequently, he became Senior Vice Chairman and then President and CEO of Bankers Trust until 1999.

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